

January 2, 2003

Luly Massaro
Clerk of the Public Utilities Commission
89 Jefferson Boulevard
Warwick, Rhode Island 02888

Re: Narragansett Electric Company Filing in Compliance with the Commission's Order in Docket No. 3444

Dear Ms. Massaro:

As part of its October 17, 2002 open meeting pertaining to Docket 3444, the Commission directed The Narragansett Electric Company ("Narragansett" or "Company") to make a filing on or before January 2, 2003 to ensure that the Company's tariffs were in compliance with recent amendments to the Rhode Island Restructuring Act that were signed into law on June 18, 2002 (the "2002 Amendments"). The Commission's order was in direct response to questions and concerns raised in the Docket 3444 proceeding as to whether the 2002 Amendments require the Company to modify the eligibility provisions of its Last Resort Service ("LRS") tariff. Accordingly, Narragansett hereby files an original and nine copies of this filing intended to address the concerns raised in that proceeding.

Summary

The Company believes that its present tariffs are in compliance with the 2002 Amendments and is not proposing any tariff changes at this time. The changes in the Last Resort Service provisions contained in the 2002 Amendments clarify that any customer not taking service under Standard Offer, and not otherwise receiving service from a competitive supplier, shall receive Last Resort Service. The statutory changes clarify the previous statutory language, which under a narrow interpretation could have been construed to limit Last Resort Service availability only to cases where the customer was "unable to obtain or retain" competitive electric supply at any cost. As discussed in detail below, the eligibility provisions of the presently effective Last Resort and Standard Offer Service tariffs comply with the 2002 Amendments.

Although the Company does not believe that the 2002 Amendments mandate a change in Last Resort Service eligibility requirements, the 2002 Amendments do make clear that the Commission has wide latitude for establishing the terms and conditions for

providing Last Resort Service, including modifying the eligibility criteria for the service. Such changes in eligibility criteria could result in the need for Narragansett to amend its tariff. Thus, although the Commission may promulgate regulations to change the terms under which the Company provides Last Resort Service, the 2002 Amendments do not require such a change; nor does the Company believe such a change is necessary at this time. The analysis supporting the Company's position is provided below.

Background

Customer eligibility for the Company's currently approved Last Resort Service and Standard Offer Service tariffs was originally established to be consistent with the language of the Rhode Island Restructuring Act prior to the 2002 Amendments. In addition, the Company's currently approved LRS tariff establishes the LRS rate for non-residential customers at the market price for the month. Narragansett typically procures LRS supply in six-month or annual intervals. Presently, the Company has contracted for wholesale Last Resort Service supply through August 2003. The LRS tariff also requires that residential customers taking LRS be charged the Standard Offer rate. Presently, the Standard Offer rate is set at 4.662 cents per kWh and is designed to remain level through 2004.

Prior to the enactment of the 2002 Amendments, the Restructuring Act required electric utilities to provide LRS to customers "*who are no longer eligible to receive service under the standard offer . . .*" RIGL 39-1-27.3 (f) (1997). The Company is not required to make Standard Offer service available to customers who have "*elected to enter into a power supply arrangement with a non-regulated power producer . . .*" RIGL 39-1-27.3 (d) (1997).

The Company's currently approved tariffs mirror these requirements. Under the LRS tariff presently in effect, customers are only eligible to take Last Resort Service if they are "*ineligible for Standard Offer Service.*" The Standard Offer Service tariff further indicates that all customers "*who have not elected to take their electric supply from a non-regulated power producer will receive their power supply under this Standard Offer Rate until the Customer either: (1) takes it electric supply from a non-regulated power producer; or (2) takes Last Resort Service.*" The eligibility provisions of the two tariffs, taken together, make clear that a customer is only eligible to take LRS if the customer previously elected to take electric supply service from a non-regulated power producer. Once a customer has made such an election, the customer is no longer eligible to return to Standard Offer Service.

As the Commission recognized during the Docket 3444 proceeding, the recently enacted 2002 Amendments could be interpreted to imply that Standard Offer customers may be permitted to move directly to the LRS rate without the intervening requirement of electing service from a non-regulated power producer. Transcript at 110. This implication arises under revised language of the 2002 Amendments that requires the Company to "*arrange for a last resort power supply for customers who have left the*

standard offer for any reason . . .” RIGL 39-1-27.3 (c)(2002). Thus, the revised language of the statute might be interpreted as requiring a change in LRS eligibility such that customers could take service under the Last Resort Service tariff without first being required to elect to take service from a competitive supplier.

The Commission further recognized during the Docket 3444 proceeding that a tariff modification permitting customers to move to LRS without limitation could produce an unstable and potentially negative result. Transcript at pp. 112-113. For example, if Standard Offer customers were permitted to move to Last Resort Service at will, customers could migrate to the Last Resort Service at times when LRS prices are lower than the Standard Offer Service rate, but then find that they are: (1) being subjected to market volatility on a rate that is based on short-term market prices; and (2) no longer afforded the rate stability that Standard Offer Service provides. In addition, liberalized LRS eligibility would make it much more difficult for the Company’s LRS suppliers to predict customer loads on the LRS rate. This, in turn, could increase risk to Last Resort Service suppliers and could result in higher LRS prices.

Legal Analysis

First, at the heart of the Company’s analysis is a determination that, rather than automatically expanding LRS eligibility, the 2002 Amendments clarify and expand the Commission’s authority to promulgate regulations governing the provision of Last Resort Service and related tariffs. Specifically, the last sentence of Section 27.3 (c) provides that “[t]he Commission may promulgate regulations to implement this section including the terms and conditions upon which last resort service is offered and provided to customers.” RIGL 39-1-27.3 (c)(2002). In addition, other language has been added earlier in this section stating that “[t]he Commission shall have the authority and discretion to approve special tariff conditions and rates proposed by the electric distribution company that the commission finds are in the public interest,” including conditions governing the provision and terms of Last Rest Service. Id. Thus, rather than requiring the Commission to direct the implementation of a specific eligibility criteria for Last Resort Service, the 2002 Amendments make clear that the Commission has wide latitude to establish tariff provisions—including aspects of eligibility—as they see fit to serve the public interest.

Second, as discussed above, there is one section of the 2002 Amendments that may give rise to different interpretations, and could, if viewed in isolation, be viewed as requiring the expansion of LRS eligibility. Specifically, RIGL 39-1-27.3 (c) provides in part that electric distribution utilities are to “*arrange for a last resort power supply for customers who have left the standard offer for any reason . . .*” Id. A narrow interpretation of this portion of the statute could construe that this amendment requires LRS eligibility to be opened to all customers without first requiring that they elect service from a non-regulated power producer. A more complete examination of the revised language, however, reveals that this amendment was part of a larger amendment designed to clarify prior language that had proved troublesome to the Commission and others in

determining who was qualified to take Last Resort Service. In Dockets 3005 and 3117, the Commission stated that it had open and unresolved issues as to who should be eligible to receive LRS service under the prior version of the statute. Order 16281 at page 24, (June 16, 2000). Specifically, the prior language in the law provided that electric distribution utilities were to arrange for a last resort power supply for customers who “*are no longer eligible to receive service under the standard offer and not adequately supplied by the market because they are unable to obtain or retain electric service from non-regulated power producers.*” RIGL 39-1-27.3 (f)(1997). This language was interpreted by some to mean that the only customers entitled to take Last Resort Service supply would be those who were not receiving Standard Offer Service, and were either (i) unable to obtain a market supply at any price or (ii) unable to afford the market price. In its August 15, 2000 comments to the Commission on this matter, the Company suggested that these kinds of interpretations would be impossible to enforce and unfair to impose. Instead, the Company proposed that eligibility for Last Resort Service should be more broadly defined to include any customer who was no longer eligible for Standard Offer Service and was without a supplier “for whatever the reasons.” Thus, it appears that the primary intent of this portion of the 2002 Amendments was to clarify and broaden the language of the statute in order to eliminate prior uncertainties about customer eligibility and ensure that any customer not eligible for Standard Offer Service could continue to have Last Resort Service as a backstop alternative. The Company presently administers its LRS tariff under this interpretation of the statute.

What is not clear on a limited reading of the modified language is whether it was also intended to make all customers eligible for Last Resort Service, regardless of whether they are also eligible to take Standard Offer Service. However, it is important to note that the revised language of Section 27.3 (c) removes any reference to customer eligibility and thus no longer prescribes which customers are eligible to take LRS. As amended, the statute only prescribes the parameters under which a distribution utility must be prepared to procure a supply for its customers. This interpretation of the amended language is completely consistent with the two new provisions that have been added to this section to make clear that it is within Commission’s discretion to approve the terms and conditions under which Last Resort Service is provided.

Another basis to interpret that the LRS was not intended to be available for all customers lies in Section 27.3 (b) of the statute. Specifically, Section 27.3 (b) precludes customers from returning to Standard Offer service, except under certain limited circumstances prescribed in Section 27.3.1 of the statute, if they have elected to enter into a power supply arrangement with a non-regulated power producer. However, there is no similar restriction for customers who have left the Standard Offer for other reasons. See RIGL 39-1-27.3 (b) and RIGL 39-1-27.3.1 (2002). Thus it appears that, while some customers would not be permitted to return to Standard Offer, others would have no such restriction. If the revised language was intended to permit all customers to be eligible for Last Resort Service, it should also have made provision for returning to the Standard Offer on a non-discriminatory basis. Indeed, if the Company were to implement changes permitting all customers to move to the LRS rate at will, it would request to uniformly restrict the ability of all such customers from returning to the Standard Offer rate.

Finally, the General Assembly's original intent in establishing Last Resort Service was to provide a service of "Last Resort", not an alternative to the market. To permit customers to select Last Resort service, at will, would be tantamount to providing them with a market alternative. The original intent of the Standard Offer was to provide all customers with the ability to share, up front, in the savings to ultimately be created by a new competitive structure and then to gradually increase Standard Offer prices over a 12-year period to allow time for the market to develop and to encourage customers to move to the market. To permit customers to move automatically from the Standard Offer rate to Last Resort Service at this time, without the necessity of first going to the retail market, would surely damage the potential development of the retail market. While it is clear that retail markets have not progressed as originally hoped, permitting customers to move automatically to Last Resort Service as currently structured would, in essence, be an admission that there is no possibility that markets will ever work. Thus, while the 2002 Amendments authorize the Commission to modify the terms and eligibility requirements for Last Resort Service if conditions in the future should warrant such modification, the 2002 Amendments do not by themselves automatically expand LRS eligibility, nor is such expansion warranted at this time.

Implementation Analysis

In the event that the Commission elects to exercise its authority provided under the 2002 Amendments to expand the eligibility of LRS as described above, the Company notes that there are several implementation issues that would need to be addressed. For example, under the present standards, non-regulated power producers notify the Company electronically when a customer wishes to leave the Standard Offer rate in favor of competitive supply. When the customer's relationship with the competitive supplier ends, either the competitive suppliers or the customers may notify the Company. The Company's system is currently configured to automatically make such a customer eligible to take service under the Last Resort Service rate. To accommodate the additional flexibility needed to expand LRS eligibility, each customer initiating a service turn-on order through Customer Service would have to be presented with a choice of whether to take Standard Offer or Last Resort Service. Such a system would have to ensure that the Company discloses the terms and risks of each option, the customer makes an affirmative choice, and there is a means to verify the customer's choice. This would require the Company to develop internal procedures and train its representatives to address these requests. Modifications to the Company's computerized Customer Information System ("CIS") would also be required.

Additional implementation issues are caused by any expansion of eligibility that would occur prior to the expiration of the Company's current LRS supply contracts. The Company's current LRS supply contracts were implicitly based on the current eligibility provisions of its tariffs. LRS suppliers should be given ample notice that customer eligibility may be changing. Thus the Company believes that any change in policy should not occur prior to the expiration of its present LRS supply contracts in August of 2003.

Finally, the Company would have significant concerns if customers who choose Last Resort Service without first going to the market were allowed to return to Standard Offer without limitation. This in turn would permit gaming of the rates and potentially significant uncertainty to the Company's suppliers about how to estimate future load and cost risk. In any event, customers should not be permitted to return to the Standard Offer once they have gone to Last Resort Service except under very limited circumstances. Pursuant to Section 27.3.1 of the statute, any customer on LRS should only be allowed to return to Standard Offer if the Commission finds that there is an insufficient presence of non-regulated power producers offering reasonably priced power supply service to customers in Rhode Island. RIGL 39-1-27.3.1 (a). However, even this facially reasonable limitation could result in gaming between LRS and Standard Offer Service.

Public Policy Analysis

Since there is a strong likelihood that Standard Offer rates will be lower than Last Resort Service rates for at least two to three more years, there is little likelihood that moving to the Last Resort Service rate would be an economic choice for customers in the near term. Thus, adding additional choices for customers at this time appears only to add to customer confusion about electric rates. It also creates the potential for customer gaming and instability for the Company's suppliers under both LRS and Standard Offer contracts. Finally, given that expanded LRS eligibility in the near term would, at most, create only a theoretical option rather than an economic one, such expansion would create unnecessary additional administrative burdens for the Company and the Commission, with little potential customer benefit.

While it is clear that the competitive marketplace has not developed as expected, it is not at all clear that expanding customer eligibility for Last Resort Service at this time is the right answer for customers in the long term. On the contrary, expanding eligibility for the Last Resort Service rate at this time would only serve to increase customer confusion, potentially create instability for customers in the future and adversely affect the development of competitive retail markets. Thus, the Company believes that additional time is needed to observe changing markets structures and generate a more thorough understanding of the future of competitive markets. Because of the stability of Standard Offer rates today and through 2004, there is time to gain a more thorough understanding of long-term solutions without significant risk or additional cost to customers or the Company.

Conclusion

The Company believes that its existing tariff comply with the provisions of the 2002 Amendments, and no modifications to the tariff is needed at this time. While the 2002 Amendments give the Commission wide latitude to modify customer eligibility for Last Resort Service, the Company does not believe that the terms of the Restructuring Act require it, nor does the Company believe it advisable to modify the current structure at this time. The Commission in its prior orders has already established customer

eligibility for both Standard Offer and Last Resort Service through careful consideration. Any further modification at this time could unnecessarily create instability and customer confusion. It would also create implementation costs to the Company and customers in order to prepare for customer switching even though it is neither likely that customers will want to switch in the next two or more years nor is it clear that customer switching is ultimately in the public interest. Although there may be reason for modification in the future, the Company believes that its present tariff provisions are consistent with the 2002 Amendments, and also present a stable standard by which the Company provides power supplies to its customers in the absence of alternative competitive supplies.

The Company will carefully observe and analyze the status of competitive markets throughout this period of relative rate stability and will make recommendations to the Commission as the future direction of competitive markets becomes clearer. Although the Company recommends no action by the Commission at this time, we will keep the Commission apprised of our ongoing analysis.

If, contrary to the Company's analysis, the Commission were to find that the 2002 Amendments mandate modification to the Company's tariffs, the Company requests the ability, consistent with the Restructuring Act, to propose specific amendments that address the issues presented in that case. For example, if there were a change to permit customers to move to LRS for any reason, the would need to implement new training and scripting procedures for its customer service representatives and implement changes to its CIS and billing systems to ensure that customers have sufficient information to make a fully informed decision on the matter. In addition, the Company would propose specific rules and procedures for application of the new provisions and may also need to modify its supply contracts to comply with such changes.

Thank you for your attention to our filing. Please contact me if you have any questions or otherwise wish to address this matter.

Sincerely,

Terry L. Schwennesen
General Counsel

cc: Paul Roberti
Steve Scialabba